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E.ON Position on

The influence of existing bidding zones on electricity markets

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1 General Remarks

E.ON believes that reducing/splitting existing bidding zones would increase complexity to consumers and would be difficult to explain as the overall message has been that we are building an integrated European market and not splitting up existing national markets in submarkets. Other measures to increase market efficiency and security of supply should have preference over reducing/splitting existing bidding zones.

2 Specific Remarks

Questions

Question 1

How appropriate do you consider the measure of redefining zones compared to other measures, such as, continued or possibly increased application of redispatching actions or increased investment in transmission infrastructure to deal with congestion management and/or loop flows related issues? What is the trade-off between these choices and how should the costs attached to each (e.g. redispatching costs) be distributed and recovered?

The physics of the system is deciding the possible flows in the European system. Any new configuration of bidding zones will not change the physics of the system and only to a minor extent the socioeconomic costs. Changing configuration of bidding zones will only change the way the system operation is run and how it is paid for. Increasing investments in transmission infrastructure is the most appropriate measure and can as well lower the socioeconomic costs and costs to consumers. All transmission investments with positive socio economic value shall be built, but this means that there will always be a demand for some redispatching as it would be too expensive to get a copper plate. Redispatching is done to compensate for a lack of transmission investments. Redispatching costs should therefore be part of the transmission tariff and a proper split between TSOs has to be found. It is foreseen that congestion management will increase in distribution networks as more intermittent generation will make it too expensive to get a copper plate at the distribution level as well. Smart markets will make it possible to make congestion management in a market based way in the distribution network.

E.ON believes that through the increasing share of renewables and through the changing requirements of flexibility the congestions in the grid are not static. Hence redefining or reducing zones will not be able to solve all congestions within bidding zones.

Question 2

Do you perceive the existing bidding zone configuration to be efficient with respect to overall market efficiency (efficient dispatch of generation and load, liquidity, market power, redispatching costs, etc.) or do you consider that the bidding zone configuration can be improved? Which advantages or disadvantages do you see in having bidding zones of similar size or different size?

E.ON believes that the bidding zone configuration can be improved. Large bidding zones make it possible to find liquidity in forward markets to enable hedging of our customer portfolios as well as our generation. This makes markets more competitive in wholesale as well as retail. E.ON would



therefore like to see that smaller bidding zones, such as the Swedish bidding zones, are merged to larger bidding zones.

Question 3

Do you deem that the current bidding zones configuration allows for an optimal use of existing transmission infrastructure or do you think that existing transmission infrastructure could be used more efficiently and how? Additionally, do you think that the configuration of bidding zones influences the effectiveness of flow-based capacity calculation and allocation?

E.ON believes that further market integration and application of market coupling, cross-border intraday and balancing markets together with cross-border redispatching and increased cooperation of system operation will allow for a more optimal use of the existing transmission infrastructure. Bidding zone reconfigurations would just to a minor extent influence the system costs, but it would influence the split between costs in the energy market and the redispatching costs.

Question 4

How are you impacted by the current structure of bidding zones, especially in terms of potential discrimination (e.g. between internal and cross-zonal exchanges, among different categories of market participants, among market participants in different member states, etc.)? In particular, does the bidding zones configuration limit cross-border capacity to be offered for allocation? Does this have an impact on you?

Any congestion between bidding zones will discriminate market participants in different bidding zones, as electricity is not allowed to commercially flow unrestricted between different bidding zones. Larger bidding zones would therefore reduce discrimination of market participants, as electricity would be allowed to commercially flow unrestricted within a larger area.

Question 5

Would a reconfiguration of bidding zones in the presence of EU-wide market coupling significantly influence the liquidity within the day-ahead and intraday market and in which way? What would be the impact on forward market liquidity and what are the available options to ensure or achieve liquidity in the forward market?

Demand/supply will at least short term remain unchanged in case of reconfiguration of bidding zones and therefore liquidity would probably not be an issue in day-ahead markets. However liquidity would be a problem in the intraday and forward markets as the underlying volume would be less in each bidding zone in case of smaller bidding zones. A lesson learned from the splitting up of Sweden in smaller bidding zones is that the liquidity in the smaller bidding zones has become a problem, especially in the bidding zones where there is no balance between generation and consumption within the bidding zone. One example is the bidding zone Sweden 4 where the liquidity in the local CfD market is too low to enable efficient hedging. Contrary to the statement in 2.4 of the

consultation document, the system price liquidity only cannot be evaluated as a CfD contracted is needed as well to hedge consumption or generation in the forward market.

Liquidity in forward markets can be achieved by

- Large bidding zones as the underlying volumes are larger
- Balance between generation and consumption within each bidding zone to enable fundamental supply and demand to meet in the forward market
- Allocation of transmission rights to enable cross-border competition in the forward market

Question 6

Are there sufficient possibilities to hedge electricity prices in the long term in the bidding zones you are active in? If not, what changes would be needed to ensure sufficient hedging opportunities? Are the transaction costs related to hedging significant or too high and how could they be reduced?

We find sufficient possibilities to hedge electricity prices in the long term in a few markets only, with the best possibilities in Germany. There are a number of changes that need to be done to facilitate hedging opportunities. Deletion of regulated prices would increase incentives to hedge electricity prices. Financial regulation has to consider the needs for energy companies to hedge their positions to avoid that trading is getting too expensive. Reducing size of bidding zones would clearly reduce liquidity in the forward market and make hedging more expensive.

Question 7

Do you think that the current bidding zones configuration provides adequate price signals for investment in transmission and generation/consumption? Can you provide any concrete example or experience where price signals were/are inappropriate/appropriate for investment?

Generation investments are very long term and a stable bidding zone configuration is important to investors. We are assuming that significant price differences will be reduced long term as cross-border transmission investments should be done in case of significant congestions. Bidding zone configuration will have an impact on capacity mechanism pricing as well as the energy price. In general small bidding zones increase the investment risk as a single change in generation/consumption has a larger price effect as in a larger bidding zone. Bidding zone configuration should have no effect on regulated transmission investments, as the investment need will be signalled either by redispatching costs or congestion rent.

Question 8

Is market power an important issue in the bidding zones you are active in? If so, how is it reflected and what are the consequences? What would need to be done to mitigate the market power in these zones? Which indicator would you suggest to measure market power taking into account that markets are interconnected²?

We believe that the reference "This information would be primarily useful for ENTSO-E when performing the bidding zone review process" is wrong, as market power issues is a task for regulators and competition authorities, not TSOs.

Question 9

As the reporting process (Activity 1 and Activity 2) will be followed by a review of bidding zones (Activity 4), stakeholders are also invited to provide some expectations about this process. Specifically, which parameters and assumptions should ENTSO-E consider in the review of bidding zones when defining scenarios (e.g. generation pattern, electricity prices) or alternative bidding zone configurations? Are there other aspects not explicitly considered in the draft CACM network code that should be taken into account and if so how to quantify their influence in terms of costs and benefits?

E.ON believes that ENTSO-E should consider timelines for transmission investments as planned in the ten year development plan in addition to the criteria mentioned in article 38 of the draft network code on CACM.

Question 10

In the process for redefining bidding zones configuration, what do you think are the most important factors that NRAs should consider? Do you have any other comments related to the questions raised or considerations provided in this consultation document?

We see the configuration of price zones as part of a market efficiency assessment. Market efficiency should be assessed by regulators/ACER and not by TSOs that may have incentives that influence the result. E.ON believes that NRAs should consider the following issues in addition to the criteria mentioned in article 38 of the draft network code on CACM.

- Stability of commercial transactions and impact on long-term contracts;
- Influence on hedging possibilities and disruption of existing commercial strategies that allow suppliers to offer stable prices to customers;
- Investment certainty;
- Costs for adjustment of delivery points in all existing and legacy contracts;



- Potential costs for renegotiation of contracts which may lead to massive losses and risk for legal processes related to this;
- Costs for re-organisation and IT;

It is very important that the impacts of bidding zone delimitation on electricity retail companies and electricity consumers are taken into account. These increased transactions costs will be passed through to market participants and ultimately customers, who will have to face higher electricity prices.

Experiences from Sweden when implementing new bidding zones show that it is crucial that the NRA (or other authorities) has a good information process that explains to the customers what the new bidding zones mean and how it will affect consumer costs. There is a strong opposition in the south of Sweden towards the implementation of bidding zones in Sweden because this decreases the competitiveness of industrial consumers located in this bidding zone.

It is also important that the lead time is long enough to give the retailers time to make contractual changes (in fixed price contracts) to avoid any discussions about correcting ongoing fixed price contracts when the effects of the new bidding zones occur.

Even if the effects on spot prices in Sweden (between bidding zone 3 and 4) have been small it is also identified that when price differences occur they will be very high. This has a negative effect on the CfD price and thereby on the long term customer contracts. It is important that the additional income revenue for the TSO is used to build new/strengthen existing cross-border transmission.